Supreme Court of the United States

October Term, 1942

No. 61

IN THE MATTER

of

THE WESTERN PACIFIC RAILROAD COMPANY, a corporation,

Debtor.

IRVING TRUST COMPANY, as Substituted Trustee under the General and Refunding Mortgage of The Western Pacific Railroad Company,

Petitioner,

against

CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO and SAMUEL ARMSTRONG, as Trustees under The Western Pacific Railroad Company First Mortgage dated June 26, 1916; FREDERICK H. ECKER, JOHN W. STEDMAN and REEVE SCHLEY, constituting the Institutional Bondholders Committee; WESTERN PACIFIC RAILROAD CORPORATION; THE WESTERN PACIFIC RAILROAD COMPANY; A. C. JAMES CO.; THE RAILROAD CREDIT CORPORATION; and RECONSTRUCTION FINANCE CORPORATION.

Respondents.

ANSWERING BRIEF FOR INSTITUTIONAL BONDHOLDERS COMMITTEE, RESPONDENT

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

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October 2, 1942.

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OPINIONS BELOW

The opinion of the District Court, dated August 15, 1940, is reported at 34 F. Supp. 493.[1] The opinion of the Circuit Court of Appeals, dated November 28, 1941, is reported at 124 F. (2d) 136.[2]

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[1] R. 1569.

[2] R. 2663.

JURISDICTION

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 [28 U. S. C. § 347(a)].

QUESTIONS PRESENTED

The issue upon the writ of certiorari granted to Irving Trust Company, as Refunding Mortgage Trustee, is whether the Interstate Commerce Commission (hereinafter called the Commission) and the United States District Court for the Northern District of California, Southern Division, were correct in denying the Refunding Mortgage Trustee's claims

(1) that the Refunding Mortgage is the sole lien on the Debtor's equity in equipment bought for use and used on First Mortgage lines, the purchase of which was financed by the Debtor under equipment trust agreements;

(2) that the lien of the First Mortgage upon the Northern California Extension is limited to either (a) a lien upon only a part of the mileage of the Northern California Extension, the Refunding Mortgage being a first lien upon the remainder of the Extension, or (b) a lien only upon an undivided interest in the entire Extension *pari passu* with a lien of the Refunding Mortgage upon the remaining undivided interest; and

(3) that neither Mortgage is a lien on certain so-called non-carrier real estate, or on cash or current assets on hand at the date of the institution of this proceeding, and that, therefore, the Refunding Bonds

are entitled to new securities representing an interest therein on the basis of an alleged deficiency judgment on the Refunding Mortgage Bonds.

As indicated in the main brief of the Institutional Bondholders Committee (hereinafter called the Committee) upon its own writ of certiorari (No. 7), the Committee agrees with the Refunding Mortgage Trustee that, notwithstanding the failure of the Circuit Court of Appeals to pass upon these issues properly raised before it, this Court should determine the issues in order to expedite the Western Pacific reorganization.

STATEMENT

The Committee will rely on the answering brief of the Trustees under the First Mortgage for a detailed statement of the facts and the law establishing the fallacy of the Refunding Mortgage Trustee's contentions.

On the one hand, the brief of the Refunding Mortgage Trustee omits to state most of the material facts upon which determination of the three claims must depend. On the other hand, in order to avoid any failure to disclose any of the material facts the non-disclosure of which would make those disclosed misleading, the answering brief of the First Mortgage Trustees has stated the relevant facts in most complete detail. The Committee therefore believes that it will be of assistance to this Court to accent, from among the many relevant facts, those which, in the Committee's opinion, conclusively negative any basis for the three contentions.

ARGUMENT

I

THE GRANTING CLAUSES OF THE FIRST MORTGAGE

The Granting Clauses of the First Mortgage[1] strikingly evidence the intent of its draftsman to accomplish two major purposes:

(1) that the First Mortgage should in the first instance constitute a first lien upon the entire venture taken over by the Debtor from its predecessor in the 1916 reorganization; and

(2) that the First Mortgage should draw to itself, through its after-acquired property clauses, a first lien on all property of every character thereafter acquired by the Debtor for use in connection with the mortgaged property or on account of the acquisition or construction of which, or any work thereon, any First Mortgage Bonds or proceeds thereof were expended.

The draftsman made it abundantly clear that this First Mortgage was to be and remain a first lien for the aggregate amount of Bonds at any time outstanding upon that enterprise as an entirety and that no loopholes were to be left whereby the effective lien upon the enterprise might be whittled away by the Debtor, whether intentionally or unintentionally, for the benefit of subsequent creditors.

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[1]These Granting Clauses are set forth in full at R. 1215-29.

Granting Clause First covers both in detail and by a general statement all "real and personal property and interests and rights in property" which had been owned by the Debtor's predecessor in title, "or to which it may be entitled," except only cash items. Paragraphs I to VI, inclusive, cover in detail the specific railroad lines and classes of property. Paragraph VII covers "All and singular the property, interests and rights" [except cash items] "which belong to the Company or to which it may be entitled in any manner and which heretofore were owned by" the Debtor's predecessor in title.

To make certain that there was no mistake of the purport of Paragraph VII, Granting Clause Second subjected to the Mortgage

> "All other lines of railroad, extensions, branches, terminals, lands, structures, equipment, shares of stock, bonds, notes and other securities, claims, franchises, privileges and immunities and other property and estates, interests and rights (whether legal or equitable) now owned by or belonging to the Company, notwithstanding the same or any thereof may not be particularly set forth in these granting clauses."

This probably is the language to which the Refunding Mortgage Trustee's brief refers in its cautious concession that "there is some language in the First Mortgage which may be broad enough to cover pre-existing non-carrier real estate" (p. 53). That characterization is a considerable understatement. The language above quoted makes it clear that as to all property which the Debtor owned or to which it was entitled on the date of the execution of the First Mortgage, June 26, 1916, (whether or not such property

was of a character which by subsequent accounting practice later became known as "carrier" or "non-carrier" property) the First Mortgage became and remains a first lien.

Granting Clause Third covers "Any and all property and facilities of any and every kind and description * * * which may from time to time hereafter be acquired or constructed by or belong to" the Debtor if such after-acquired property falls within one of four specified categories:

(1) If any "First Mortgage Bonds or proceeds thereof or cash deposited" under the First Mortgage have been authenticated or paid out "*on account of* the purchase, acquisition or construction thereof or work thereon;"[1] or

(2) If the property constitutes "an integral part or parts of lines of railroad, extensions, branches, or other property subject to the lien" of the First Mortgage "or some other integral portion whereof is * * * subject to the lien hereof;" or

(3) If the property is "used or acquired for use in or for the maintenance or operation of or appertaining to" any of the property subject to the lien of the First Mortgage; or

(4) If the property consists of securities of named companies or of any subsidiary company, as defined.

Granting Clause Fourth covers all properties which might thereafter be specifically mortgaged or pledged with

[1]All italics in quoted matter throughout this brief have been supplied, unless the contrary is indicated.

the First Mortgage Trustees, and is not relevant to any of the issues here in controversy.

Granting Clause Fifth covers, with a multiplicity of verbiage, substantially every kind of property and facility used or useful in the operation of a railroad (including, expressly, *equipment*) and

> "all other property of every description and *all rights and interests in or with respect to the use of property* * * * whether now owned by the Company or *at any time hereafter acquired* by it * * * appurtenant to or *used* or held for use as, or as a part or as parts of, or *to facilitate* or safeguard the *maintenance or operation of, any lines of railroad, extensions*, branches, * * * or other properties now or at any time hereafter subject to the lien of this indenture—whether the same exclusively appertain to or be used as parts of or in or for the maintenance or operation of lines of railway or other properties subject to the lien hereof or appertain to or be so used as parts of or in or for the maintenance or operation of such lines of railroad or other properties in common with lines of railroad or property not subject to the lien hereof; * * * also any and all *replacements* * * * of and *additions* to * * * any property or rights of whatsoever description now or at any time hereafter subject to the lien of this indenture, whensoever and by whomsoever such replacements * * * or additions may be made."

Granting Clause Sixth covers all possible "estates, rights, titles, interests, possession, claims and demands, whatsoever, *as well at law as in equity*," of the Debtor in or to any property, including expressly equipment and lands.

There then follows a proviso permitting the Debtor by the use of free funds to acquire property free of the lien

of the First Mortgage, *but only if such property is not of the character described in one of the four sub-divisions of Granting Clause Third* (see p. 6, *supra*). This, it will be noted, is not one of those "free funds" provisions, such as were involved in the mortgages construed in the *Wabash*[1] and *Rock Island*[2] cases discussed by the Refunding Mortgage Trustee at pages 27 to 32 of its brief, under which all equipment purchased with free funds, whether or not for use upon the mortgaged lines of railroad, was to be excluded from the lien of the mortgage.

It will thus be seen that, by the express provisions of these Granting Clauses, all property and rights in property which the Debtor acquired after June 26, 1916, became subject to the First Mortgage,—except only property which was in substance of a character wholly independent from the Debtor's properties owned at the time of the creation of the Mortgage or thereafter subjected to it, and even then only if no First Mortgage Bonds or proceeds thereof were used "*on account of* the purchase, acquisition or *construction* thereof *or work thereon.*"

In the light of these Clauses it is clear that all the Debtor's property (except only the Tidewater Southern stock and note, the Central California Traction stock and bonds, the Alameda Belt Line stock, and cash) is subject to the lien of the First Mortgage.

Following the so-called "free funds" proviso is a clause permitting the financing of equipment purchases by purchase money liens prior to the lien of the First Mortgage either through the device of "lease, conditional sale agree-

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[1] *Equitable Trust Co.* v. *Wabash Railroad Co.*, (unreported, D. C. Mo., 1921).

[2] *In re Chicago Rock Island & Pacific Ry.*, (unreported, D. C. Ill., 1939).

ment * * * or equipment trust" under which legal title would be retained by the vendor, the Debtor obtaining only an "equity," or by chattel mortgage permitted to be "superior to the lien of" the First Mortgage. These latter clauses, which will be discussed later in greater detail, thus permitted the lien of the First Mortgage upon new equipment so acquired by the Debtor to be subordinated to the lien of the financing media, as was made doubly clear by the Habendum Clause,

> "Subject, However, * * * as to equipment hereafter acquired, to the equipment trust or conditional sale agreements to which the same shall be subject as permitted hereby, * * *."[1]

The grant and conveyance under the First Mortgage is expressed to be "in order to secure the payment of *all of said bonds* * * * at any time issued and outstanding * * *."

The grant in trust is expressed to be "for the equal and proportionate benefit and security of all present and future holders of First Mortgage Bonds * * * without preference, priority or distinction as to lien or otherwise of one bond over any other bond * * * so that each and every bond hereby secured shall have the same right, lien and privilege * * * and * * * be equally and proportionately secured hereby, as if all the First Mortgage Bonds had been made, * * * delivered and negotiated simultaneously * * *."

The Granting Clauses thus make the First Mortgage a lien for the full amount of the debt thereunder upon all the Debtor's initially acquired property, upon all property and rights in property thereafter acquired for use in connection with any of the First Mortgage property and upon all property "on account of the purchase, acquisition or con-

[1]R. 1230.

struction thereof or work thereon" First Mortgage Bonds or their proceeds are used. Not a shadow of foundation can be found for the suggestion that upon any specific piece of property the First Mortgage is a lien only to the amount of the First Mortgage Bonds or proceeds thereof spent on that particular piece of property. It is doubtful that any responsible issuer has ever imposed on the public any such financial monstrosity as would result from this suggestion of the Refunding Mortgage Trustee.

This First Mortgage is clear that, if any proceeds of First Mortgage Bonds have been spent in connection with the acquisition or construction of any piece of property, or any work thereon, that piece of property, *as an entirety*, must be subjected to the First Mortgage as security for the First Mortgage debt *as an entirety*. The Refunding Mortgage Trustee's attempted "interpretation" of the First Mortgage would produce the absurdities (1) that it was the intent of the First Mortgage to permit its security gradually to be frittered away as property existing in 1916 was replaced by new property, particularly in respect of equipment, and (2) that upon a foreclosure of the First Mortgage the Court would have to go up and down the lines of the system, find the specific bits of property in respect of which First Mortgage moneys had been expended, and, if such property had not been acquired entirely by the use of First Mortgage funds, grant to the First Mortgage Bonds security only in the proportion which their funds had contributed to the cost of the particular bits of property. The accounting problems involved in giving effect to any such construction, quite apart from the injustice to the First Mortgage Bondholders, demonstrate the unrealistic character of the suggestions of the Refunding Mortgage Trustee.

II

THE FIRST MORTGAGE LIEN ON EQUIPMENT

Admittedly, every unit of equipment owned by the Debtor, whether acquired through equipment trusts or otherwise, was in fact used on the lines of railroad subject to the First Mortgage as a first lien.[1]

This equipment, it is also conceded, would be subject to the First Mortgage as a first lien, notwithstanding no issue of First Mortgage Bonds in connection with its acquisition, if its acquisition had been financed by cash payments out of earnings or by chattel mortgage or by a combination of those two methods. But because of the chance circumstances that three lots of equipment necessary to the operation of the First Mortgage properties were purchased under Philadelphia Plan equipment trusts in 1923, 1924 and 1929, and a fourth lot was purchased under the Baldwin Lease of 1931 (the vendor in each case reserving legal title and the Debtor immediately obtaining only a right of use and ultimate acquisition), the Refunding Mortgage Trustee claims a prior lien under the Refunding Mortgage created in 1932.

It is submitted that by the terms of the Granting Clauses of the First Mortgage (Clauses Third, Fifth and the proviso relating to free funds), all right and interest of the Debtor to use and ultimately acquire title to that equipment, *i. e.*, the equity of the Debtor, is subject to the lien of the First Mortgage in priority to the Refunding Mortgage. The payments, from time to time as they become due, of instalments of equipment trust certificates

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[1]R. 1075.

(both those prior to the creation of the Refunding Mortgage in 1932, and those since the creation of the Refunding Mortgage), have operated to feed the security afforded by the First Mortgage to the extent of the Debtor's increasing equity in the equipment resulting from such payments. Those additions to the security more or less offset the constant depreciation in value of all the equipment upon which the First Mortgage is a first lien.

The Refunding Mortgage Trustee's answer is that the Court should wrench from its context the equipment financing clause at the end of the Granting Clauses of the First Mortgage which permits subordination of the First Mortgage lien to equipment obligations issued to finance new equipment, and should then construe that clause to negative the effect of all the other provisions of the First Mortgage with respect to equipment. The clause, which is a part of the "free funds" proviso, reads as follows:

> "and the Company may, unless First Mortgage Bonds shall have been authenticated and delivered or their proceeds or other cash deposited hereunder paid out against the same, purchase and acquire equipment, *free from the lien hereof,* by lease, conditional sale agreement or under any form of equipment trust, or purchase such equipment and issue obligations therefor secured by mortgage or pledge of such equipment *superior to the lien of this indenture.*"[1]

To this contention of the Refunding Mortgage Trustee the Commission and the District Court correctly accepted as a complete answer the fact that the clause must be construed, not only in the light of the language which pre-

[1] R. 1229.

cedes it in the same paragraph evidencing the intent that the First Mortgage should be a lien upon a railroad venture as an entirety (*i. e.*, not only the rails but all rights in respect of equipment used on the rails), but also in the light of the subsequent paragraph of the Habendum Clause which reads:

> "SUBJECT, HOWEVER, * * * as to equipment hereafter acquired, to the equipment trust or conditional sale agreements to which the same shall be subject as permitted hereby, * * *."[1]

As the Commission concisely stated in its Original Report:

> "If all equipment acquired under equipment trusts was to be entirely free of the lien of the first mortgage, it is not apparent why the words 'equipment trust or conditional sale agreements to which the same shall be subject as permitted hereby' were made part of the last quoted provision."[2]

The Refunding Mortgage Trustee urges, in reply to the Commission, that the quoted reference is to a provision of the First Mortgage claimed by the Refunding Mortgage Trustee to permit financing of an equipment purchase by the use of both First Mortgage Bonds and equipment trust certificates at the same time. The difficulty with the Refunding Mortgage Trustee's reply is, as pointed out in the brief of the First Mortgage Trustees,[3] that there is no such provision in the First Mortgage, and, as a matter of reasonable and sound financing, there couldn't be.

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[1]R. 1230.
[2]R. 266.
[3]Answering brief of the First Mortgage Trustees, pp. 25-28.

The Refunding Mortgage Trustee appeals to what it calls a "practical interpretation" of the First Mortgage.[1] The Committee agrees that a "practical interpretation" must be made of the equipment financing clause in the light of the customary methods of purchasing railroad equipment. The purpose of the clause becomes simple and clear, despite the efforts of the Refunding Mortgage Trustee to becloud it, when the practical methods of purchasing railroad equipment are kept in mind. Upon buying equipment, the Debtor might (1) pay for it in cash out of so-called free funds; (2) finance it by the issue of First Mortgage Bonds; (3) finance it by chattel mortgage; or (4) finance it by "* * * lease, conditional sale agreement or under any form of equipment trust * * *."

While legal title to the purchased equipment would vest in the Debtor under the first three enumerated forms of acquisition, under the fourth form of acquisition the technical legal title would remain in the lessor, conditional vendor or equipment trustee as security, the Debtor having only the rights of use and of ultimate acquisition of technical legal title upon full payment of the equipment obligations. These rights are commonly referred to as the "equity" of the purchaser.

It is undisputed that as to all equipment purchased by the Debtor under either the first or second of the above enumerated forms of financing, the First Mortgage would become a first lien, in both cases because of the lien of the First Mortgage upon all Debtor-owned railroad property, including equipment, and in the second case, also because of financing the purchase out of the proceeds of First Mort-

[1]Refunding Mortgage Trustee's brief, p. 26.

gage Bonds. It is equally undisputed that had the Debtor purchased any equipment under the third form of financing (chattel mortgage), the First Mortgage would have become a lien thereon subject only to the superior lien of the chattel mortgage upon the purchased equipment. This is expressly provided by the last few words of the very equipment financing clause which the Refunding Mortgage Trustee attempts to misconstrue. The Refunding Mortgage Trustee's position therefore is that, merely because the equipment here in question happened to be financed by the fourth specified method, not only the legal title thereto, but all rights of the Debtor therein, are wholly free from the lien of the First Mortgage.

With the practical facts in mind, analysis of the clause itself evidences that the words upon which the Refunding Mortgage Trustee relies, viz., "free from the lien hereof," were used in the technical sense that the legal title to the equipment could be vested in the trustee of an equipment trust and that *such legal title* would be free from the lien of the First Mortgage.

The fact that the clause goes on to provide that obligations created by the Debtor in the purchase of such equipment might be "secured by mortgage or pledge of such equipment superior to the lien of this indenture" clearly indicates an intent that the equity or rights of use and acquisition of the Debtor in equipment subject to such "lease, conditional sale agreement or * * * form of equipment trust," as contrasted with the legal title, should be subject to the lien of the First Mortgage. That right of use and acquisition is expressly subjected to the lien of the First Mortgage by Granting Clause

Fifth, which covers "all rights and interests in or with respect to the use of property * * * at any time hereafter acquired * * * for use * * * to facilitate or safeguard the maintenance or operation of" any of the property subject to the lien of the First Mortgage.

The purpose of the equipment financing clause, therefore, was not to create an exception to *any* coverage by the First Mortgage of all equipment used upon the lines of railroad subject to that Mortgage, but to create an exception only to the *first lien character* of that First Mortgage coverage. The purpose of that exception was to permit the financing of new equipment either by the conventional form of equipment trust under which the legal title is not immediately vested in the purchaser, or by the chattel mortgage form of equipment obligation under which the purchaser gets legal title subject to a purchase money lien. Any other construction would produce the highly strained result that whether the rights and interests of the Debtor in equipment purchased for use on lines of railroad subject to the First Mortgage became (a) subject to the lien of that Mortgage or (b) wholly free from the lien of that Mortgage would depend upon the pure accident of the method which the Debtor chose for financing the purchase, or, worse, upon design of the Debtor hostile to the interests of the First Mortgage Bondholders.

Since the lien of the First Mortgage, by its express terms, attached to all the Debtor's rights of use and acquisition in all such equipment trust equipment immediately upon its being acquired by the Debtor, notwithstanding that the legal title was technically in an equipment trustee, there was no necessity of incorporating in the First Mortgage any express provision that, as the senior lien of the equipment

obligations disappeared through payment, the lien of the First Mortgage on the Debtor's rights in the equipment should thereby increase. Three times in its brief,[1] however, the Refunding Mortgage Trustee urges that the inclusion of such an express provision in the Refunding Mortgage in 1932 must be taken as indicating that its omission from the First Mortgage in 1916 left in the First Mortgage a gap through which all the equipment on the First Mortgage lines could be drained away from the First Mortgage Bondholders. But the inclusion of such an express provision in the First Mortgage in 1916 would have been clearly surplusage in the light of all the provisions of the Granting Clauses already quoted. Indeed, it was surplusage in the Refunding Mortgage in 1932. That provision is but an illustration of the increasing excess of care taken by draftsmen of corporate documents over the period between 1916 and 1932 in working out provisions to lay the ghosts of such unfounded contentions as that of the Refunding Mortgage Trustee.

The Refunding Mortgage Trustee also seems to make a point of the fact that "application of * * * money obtained from Refunding Mortgage creditors" had reduced the indebtedness under the equipment obligations outstanding under the equipment trusts and lease in question.[2] The term "Refunding Mortgage creditors" must have been carefully chosen by the Refunding Mortgage Trustee to avoid any misleading implication that any payments of the equipment obligations were funded under the Refunding Mortgage, either through the issue of Refunding Mortgage Bonds or the use of cash deposited under that Mortgage. The facts are that no such moneys were so provided, that of

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[1]Pages 19, 22 and 25.

[2]Brief of Refunding Mortgage Trustee, p. 17.

the three pledgees of Refunding Mortgage Bonds, ACJ[1] and RCC provided no such moneys, and that out of moneys borrowed against the RFC Notes secured by the pledge of Refunding Mortgage Bonds and other collateral, $406,466 was applied in 1935 to one maturity of the 1923 equipment trust obligations and one maturity under the Baldwin Lease.[2] These payments could not operate to divest any part of the lien of the First Mortgage upon the Debtor's rights in the equipment.

Reference has been made to the Refunding Mortgage Trustee's argument for a "practical interpretation" of the First Mortgage. It bases its argument upon certain of the Debtor's Listing Applications for First Mortgage Bonds.[3] When the facts, omitted from the Refunding Mortgage Trustee's brief, with reference to these Listing Applications are appreciated, the argument becomes a somewhat weird reversal of the general doctrine enunciated by this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307 (1939).

In those Listing Applications, the first in 1925 and the last in 1931, the Debtor, one of the James Interests corporate entities,[4] described the equipment in question as "un-

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[1]Hereinafter the following abbreviations are used: ACJ—A. C. James Co.; RCC—Railroad Credit Corporation; RFC—Reconstruction Finance Corporation; WP Corp.—Western Pacific Railroad Corporation.

[2]R. 1055.

[3]Refunding Mortgage Trustee's brief, p. 26.

[4]As noted in the Committee's main brief (p. 50), the interests controlled by Mr. A. C. James (now his estate) own, in addition to the ACJ Notes, more than $8,000,000 of the First Mortgage Bonds of the Debtor and 8.76% of the outstanding Preferred Stock and 61.2% of the outstanding Common Stock, or 40.36% of all the outstanding capital stock, of WP Corp. WP Corp., with its 100% owned subsidiary, Western Realty Company, in turn owns all the unsecured debt, Preferred Stock and Common Stock of the Debtor.

mortgaged." The statement was far from an admission against the interests of the Debtor in favor of the First Mortgage Bonds. It was a self-serving declaration of one James Interests corporate entity, the Debtor itself, first in its own interest, and then in the interest of two other James Interests corporate entities, WP Corp. and ACJ as holders of substantially all of the Debtor's unsecured debt. Now after ACJ has converted its then unsecured Debentures into the ACJ Notes,[1] the self-serving declaration is asserted in the interest of the Refunding Mortgage Bonds pledged to secure the ACJ Notes. With these facts in mind, it is submited that it is unnecessary for the Court to give any great thought to the problem of when a Listing Application is or is not binding upon the holders of securities to which it relates.

In the light of all the foregoing facts, the first lien of the First Mortgage, as against the Refunding Mortgage, upon the Debtor's rights of use and acquisition of the equipment trust and Baldwin Lease equipment need not depend upon the three separate replacement covenants contained in the First Mortgage or the replacement and additions grant contained in the Granting Clauses. As pointed out in the brief of the First Mortgage Trustees,[2] however, the First Mortgage, as a result of those provisions, had attached as a first lien to all rights of the Debtor in the disputed equipment long before the Refunding Mortgage was created in 1932.

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[1]Referred to in the next section of this brief.

[2]Pages 37 *et seq.*

III

THE NORTHERN CALIFORNIA EXTENSION

The omissions from the Refunding Mortgage Trustee's brief of the material facts respecting the Northern California Extension are so many and so vital that their omission causes the statements of fact which are contained in the Refunding Trustee's brief to be wholly misleading.

1. Authorization and Construction—Change of Original Intent

Application for authority to construct the so-called Northern California Extension was made to the Interstate Commerce Commission by the Debtor on February 8, 1929.[1] At that time it was estimated that the cost would be $5,000,000. On May 14, 1929, ACJ offered to provide the necessary funds against the issue to ACJ of bonds and notes to be secured by a first lien on the Extension.[2]

Later, upon making a change in the route and new estimates, it was found that the construction would approximate $10,000,000. This necessitated new arrangements for financing. Under a superseding offer dated June 19, 1929, ACJ offered (as its intervening petition before the Commission in this proceeding recognizes) to furnish $5,000,000 "upon evidences of debt which were junior to the First Mortgage."[3] ACJ agreed to purchase

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[1] I. C. C. Ex. 79 (see R. 2433-34) not printed. All such unprinted exhibits hereinafter referred to are before this Court pursuant to the Stipulation filed July 23, 1942.

[2] I. C. C. Ex. 45 (see R. 2316), not printed.

[3] ACJ Petition for Intervention before I. C. C., verified April 18, 1936, p. 6 (not printed); I. C. C. Ex. 46 (see R. 2319, 1079), not printed.

$5,000,000 of unsecured 5% Debentures, provided $5,000,000 of First Mortgage Bonds were also sold to provide construction funds.[1]

The indenture, under which the Debentures to be acquired by ACJ were issued, was executed on January 6, 1931.[2] It was wholly without mortgage or pledge of any property, and made no pretense of constituting a lien on any of the property of the Debtor.

Construction had been commenced in August, 1930. The Extension was substantially completed and put into operation for freight service on November 10, 1931,[3] not June 1, 1932, as stated by the Refunding Mortgage Trustee.[4]

2. The Sale of Debentures to ACJ

The $5,000,000 of Debentures were sold to ACJ in February, 1931, pursuant to published notice inviting bids, specifications describing the Debentures, and receipt of bid.[5]

The Refunding Mortgage Trustee's brief contains the following argument (at pp. 43-44):

> "Even the 'specifications of the securities offered for sale' at the time of the issue of the First Mortgage bonds (Ex. 93) which were used in financing the Extension did not promise a first lien upon the entire Extension. They read:
>
> "'Said First Mortgage constitutes a first lien on the main line of railroad of the Company extending from San Francisco, California, to

[1] I. C. C. Ex. 46 (see R. 2319, 1079); not printed.
[2] I. C. C. Ex. 50 (see R. 2335), not printed.
[3] R. 1863, 1942. See also R. 1077.
[4] Brief, p. 41.
[5] R. 1078; I. C. C. Exs. 48 and 49 (see R. 2325-27), not printed.

> Salt Lake City, Utah, and branches, aggregating 1050.5 miles * * *. Upon the completion of the construction and/or acquisition of the Company's Northern California Extension its main line of railroad will aggregate 1198.5 miles * * *.'
>
> It would have been simple to state definitely, and it would have been definitely stated if so intended, that 'upon the completion of the Northern California Extension the First Mortgage will constitute a first lien thereon.'"

It will be remembered that the language thus quoted by the Refunding Mortgage Trustee was used in connection with the sale of First Mortgage Bonds for the express purpose of financing *half* of the construction cost of the Northern California Extension. We submit that, even if the quoted language were the sole evidence, no court should sanction the weasel interpretation suggested by the Refunding Mortgage Trustee, that the First Mortgage Trustees and Bondholders were warned by the quoted language that the First Mortgage, in violation of its express terms, was not to constitute a lien upon the entire Northern California Extension for the benefit of the entire First Mortgage debt.

Be that as it may, the Refunding Mortgage Trustee's brief omits to draw to the attention of the Court the specifications above referred to, inviting bids for the unsecured Debentures sold to ACJ to provide the remaining half of the cost of the Extension. Those specifications were publicly issued on the same day as the specifications quoted in the Refunding Mortgage Trustee's brief.[1]

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[1] R. 2324, 2327.

The Debenture specifications stated:

> "The main line of railroad of the Company extends from San Francisco, California, to Salt Lake City, Utah, with branches, and aggregates 1050.5 miles, more or less of first track. Upon the completion of the Company's 'Northern California Extension' its main line of railroad will aggregate 1198.5 miles, more or less. * * *
>
> "The First Mortgage of this Company dated June 26, 1916, securing this Company's First Mortgage Bonds, whereunder not more than *$50,000,000 thereof may be outstanding* at any one time, *is a first lien on said main line* of railroad."[1]

These specifications would seem to put the intent that the First Mortgage was to be a first lien upon the entire Extension sufficiently clearly to escape even the Refunding Mortgage Trustee's meticulous criticism of the First Mortgage specifications.

The bid, dated January 22, 1931, of ACJ[2] stated that it was made "in accordance with and subject to all the terms of the notice * * * and in accordance with the specifications referred to in said notice."

Deliveries of the Debentures were made from time to time to ACJ against payment therefor in cash, such cash being used to reimburse the Debtor for a portion of the expenditures made in connection with the construction of the Extension. The first lot of Debentures was issued and delivered on February 27, 1931, and the last lot on May 31, 1932.[3]

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[1] I. C. C. Ex. 48 (see R. 2326), not printed.

[2] I. C. C. Ex. 49 (see R. 2327), not printed.

[3] I. C. C. Exs. 95 and 97 (see R. 2463-75), not printed.

In the spring of 1932, after the Northern California Extension had been substantially completed and put into operation, the entire $5,000,000 of Debentures were exchanged by ACJ for $200 in cash and the $4,999,800 ACJ Notes secured by the pledge of Refunding Mortgage Bonds.[1]

3. Sale of $5,000,000 First Mortgage Bonds and Withdrawal of Cash Proceeds

During the period when the Debentures were being issued, the $5,000,000 of First Mortgage Bonds which were to provide that part of the Northern California Extension construction costs not provided for by the Debentures, were sold for cash pursuant to the specifications against which the Refunding Mortgage Trustee leveled the unfounded criticism above quoted from its brief.[2]

The cash proceeds were drawn down from time to time in compliance with the provisions of the First Mortgage, the Trustees having been furnished with certified copies of resolutions of the stockholders and Executive Committee of the Debtor, certificates of officers of the Debtor covering expenditures and opinions of counsel.[3]

Mr. A. C. James (the controlling interest in all the corporate entities in which the James Interests hold their various Western Pacific claims) was a member of the Executive Committee of the Debtor and attended all meetings of the Executive Committee at which the necessary resolutions were adopted authorizing the withdrawal

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[1] I. C. C. Ex. 56, p. 3 (see R. 2341), not printed.

[2] R. 1079; I. C. C. Exs. 61-73, 93 (see R. 2359-80, 2459), not printed.

[3] R. 1081; I. C. C. Exs. 61-73, 86 (see R. 2359-80, 2455), not printed.

of cash for the purpose of reimbursing the Debtor for expenditures made by it in connection with the construction of the Extension.[1] Each of these resolutions stated, among other things, that "all portions of said extension which have been constructed and/or acquired" are "subject to the lien of said First Mortgage and now in the possession of this Company."[2]

The first withdrawal of cash was made on February 11, 1931, and the last withdrawal on January 29, 1932.[3] The resolutions delivered to the First Mortgage Trustees in connection with such last withdrawal were adopted on January 29, 1932, and contained the above-quoted statement with reference to the lien of the First Mortgage on the Extension.[4] At that time the Northern California Extension had been substantially completed and was being operated for freight traffic.

The certificates of expenditures furnished to the First Mortgage Trustees in accordance with the provisions of the First Mortgage in each case stated that the expenditures had been made within a certain period and specified the particular items of property or of work in respect of which expenditures had been made by the Debtor. For example, the certificates covered land, engineering, grading, bridges, tunnels, rails, ties, ballast, stations, buildings and various other items of property and facilities ordinarily required in the construction of a railroad. The certificates further stated that, so far as known or believed by the officers executing the respective certificates, the

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[1]R. 1081; 2344-46; I. C. C. Ex. 86 (see R. 2455), not printed.
[2]I. C. C. Ex. 86 (see R. 2455), not printed.
[3]R. 1081; I. C. C. Exs. 62-73 (see R. 2366-80), not printed.
[4]I. C. C. Ex. 86 (see R. 2455), not printed.

property described in such certificates was not subject to any lien or charge except "(a) necessarily undetermined liens or charges ordinarily incident to construction and (b) the lien of said First Mortgage;" and that all deeds, conveyances and other instruments necessary to vest title to the property in the Debtor had been executed and delivered to the Debtor.[1]

The Refunding Mortgage Trustee's brief makes much of the absence of a supplemental indenture expressly subjecting the Northern California Extension to the lien of the First Mortgage and argues that "it is inconceivable that such an important acquisition as the Northern California Extension would not have been expressly subjected to the First Mortgage if it had been intended to be entirely subject to the entire First Mortgage." (pp. 43, 45)

The Refunding Mortgage Trustee's brief fails, however, to point out to this Court that the opinions of counsel delivered to the First Mortgage Trustees in accordance with the requirements of the First Mortgage were given by the then general counsel of the Debtor, Mr. F. M. Angellotti. The opinions, after referring to the officers' certificate of expenditures, stated that, in the opinion of said general counsel, the properties referred to in the certificate were subject to the lien of the First Mortgage as a first lien thereon, and that no supplemental indenture or instruments of further assurance were necessary to place said property or any part thereof under the lien of the First Mortgage.[2] These opinions (which were clearly correct) were by an officer of the Debtor, one of the James Interests corporate entities. They were acted upon by the First Mortgage

[1] I. C. C. Exs. 61-73 (see R. 2359-80), not printed.

[2] I. C. C. Exs. 61-73 (see R. 2359-80), not printed.

Trustees. They fully explain the absence of supplemental indentures. They destroy any possible basis for the Refunding Mortgage Trustee's contention that the absence of such indentures resulted in the strange 50% limitation on the First Mortgage lien for the benefit of another James Interests corporate entity, ACJ.

It was the clear purpose and intent of all the parties, and all their action was designed to the end, that the First Mortgage as an entirety should be a lien upon the entire Northern California Extension and that all funds required for the Extension, other than those realized from the First Mortgage Bonds, should not only have no lien upon the Extension itself, but should be wholly unsecured obligations of the Debtor. Mr. A. C. James actively participated in the expression of this purpose and intent.

The facts as to the Northern California Extension, taken in connection with the Granting Clauses of the First Mortgage, establish that the First Mortgage became in law and in fact a first lien upon every part of the Northern California Extension and for the entire First Mortgage debt, during every stage of the construction of the Northern California Extension. They further establish that, even if that were not so, the James Interests are in equity estopped to make any contrary claim as against the First Mortgage Bondholders.

4. The Creation of the Refunding Mortgage After the Lien of the First Mortgage Had Attached to the Extension

The Refunding Mortgage was not executed and delivered until February 29, 1932,[1] several months after the

[1] R. 1067; I. C. C. Ex. 6, pp. 168-197 (see R. 1872), not printed.

Extension had been substantially completed on November 10, 1931, and put into freight operation, and more than a year after the lien of the First Mortgage had attached.

Notice of the attachment of the lien of the First Mortgage and the priority thereof on the Extension was brought home to ACJ, RFC and RCC not only constructively but actually.

The Extension is wholly within Lassen and Plumas Counties, California.[1] The First Mortgage was recorded in those counties on July 17, 1916[2] long before the Refunding Mortgage had been created.

The fact of the priority of the First Mortgage over the Refunding Mortgage was actually brought to the attention of ACJ, RCC and RFC, not only as to ACJ by the facts heretofore recited, but also as to all three pledgees of Refunding Mortgage Bonds by the Report of the Commission,[3] approving the making to the Debtor by RFC of the first loan on the RFC Notes. In describing the bonds to be pledged as collateral for that loan the Commission said:[4]

> "The carrier offers to pledge as collateral security for the loans its general and refunding mortgage * * * bonds * * *. These bonds * * * are to be issued under a proposed new general and refunding mortgage and will be a second lien upon all the carrier's property, including personal property * * *."

After describing the collateral now physically pledged with the Refunding Mortgage Trustee, the Report con-

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[1] R. 1076.

[2] R. 1066.

[3] 180 I. C. C. 645. This Report is also I. C. C. Ex. 52 (see R. 2340), not printed.

[4] 180 I. C. C. 645 at 648.

tinued that the new bonds would be a "first lien" upon that collateral and "a lien upon substantially all the remainder of the carrier's property subject only to a first mortgage securing $50,000,000 of first mortgage bonds and about $5,000,000 of equipment-trust certificates."

By reason of transactions between RCC and RFC, in connection with the making of this loan, it is apparent that RCC had actual notice of this Commission Report.[1]

In the Debtor's application dated May 23, 1932, to RFC for a further loan it described the Refunding Mortgage as follows:[2]

> "The General and Refunding Mortgage is a first lien on certain securities having a book value of $2,374,655, and a second lien on all of the remaining property of the Railroad Company * * *."

5. The Alleged "Inequity" of the First Mortgage Lien on the Northern California Extension "to the Complete Exclusion of the Refunding Mortgage Creditors"

The brief of the Refunding Mortgage Trustee complains bitterly of the inequity of giving to the First Mortgage a lien for the entire First Mortgage debt upon the Extension as an entirety, "to the complete exclusion of the Refunding Mortgage creditors who supplied more than half its construction cost * * *" (p. 41).

Again, this expression "Refunding Mortgage creditors" carefully avoids any misrepresentation that Refunding Mortgage Bonds, or their cash proceeds deposited with the Refunding Mortgage Trustee, were issued or paid out to finance any part of the construction of the Northern

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[1] 180 I. C. C. 645 at 646-647.

[2] I. C. C. Ex. 87, p. 15 (see R. 2456), not printed.

California Extension. None of the cost was so provided, the facts as to contributions by the "Refunding Mortgage creditors" being these:

(1) ACJ, as heretofore shown, provided for half the cost of the construction against *unsecured* Debentures, the other half being financed with First Mortgage Bonds. After the Extension had been completed and the First Mortgage had become a first lien thereon, ACJ exchanged its unsecured Debentures for the ACJ Notes secured by the pledge of Refunding Mortgage Bonds expressly declared in all the contemporaneous descriptive material to constitute a second lien on the Extension.

(2) Out of the funds provided by RFC in 1932 against the RFC Notes, secured in part by the pledge of these expressly declared second lien Refunding Mortgage Bonds, $559,408 were expended upon the Extension to provide for final items not covered by the original $10,000,000 financing.[1]

(3) RCC, the other "Refunding Mortgage creditor," provided no funds used in connection with the Northern California Extension.

IV

THE ALLEGED REFUNDING MORTGAGE DEFICIENCY CLAIM AGAINST UNMORTGAGED ASSETS

1. The 1934 Subordination Agreements

The Refunding Mortgage Trustee contends that the so-called "Refunding Mortgage creditors" are entitled to

[1]R. 1055-56.

better treatment in the reorganization because of alleged rights in cash and receivables of the Debtor at the inception of the reorganization proceedings, based upon an asserted right to a deficiency judgment upon the Refunding Mortgage Bonds.

As pointed out in the main brief of the Committee[1] upon its own writ of certiorari (No. 7), this case presents no problem of dealing with such unmortgaged assets.

As of July 31, 1935 (two days before these Section 77 proceedings began), the Debtor had cash on hand amounting to $911,682.42, and receivables aggregating $1,336,664.53.[2]

While it may be true that such cash and current assets are technically free from the lien of the First Mortgage as executed, the Refunding Mortgage Trustee's brief omits to mention the existence of subsequent agreements by the so-called "Refunding Mortgage creditors," which render those assets unavailable for the satisfaction of the Debtor's general creditors.

An indisputable prior right to the cash and current assets of the Debtor was created for the First Mortgage Bondholders by the agreement effecting an extension of the 1934 interest on the First Mortgage Bonds. The interest accrued in the year 1934 amounted to $2,264,505, compared with the total cash and receivables stated above of $2,248,346.95. By agreement dated July 25, 1934, the interest accruing on the First Mortgage Bonds during the year 1934 was extended to January 1, 1937, pursuant to

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[1]Page 10.

[2]R. 1091. The figure for cash on hand is after deducting $38,120.89, representing interest paid by Tidewater Southern on its note pledged under the Refunding Mortgage.

the modified extension agreement[1] subject to the conditions set forth in the Debtor's letter of May 29, 1934,[2] as modified by the Debtor's letter of July 25, 1934.[3] Under the extension agreement RFC, ACJ, RCC (who hold as collateral all the outstanding Refunding Mortgage Bonds) and WP Corp. (the only unsecured creditor of the Debtor) agreed that until such time as the 1934 extended interest on the First Mortgage Bonds should have been paid in full, such extended interest should be entitled to priority of payment over interest and principal of the loans of said junior creditors.[4] That 1934 extended interest has never been paid and under the Commission Plan is included in the unpaid interest for which the First Mortgage Bonds receive new Common Stock.

For the information of this Court, a copy of the subordination agreement executed by ACJ is annexed as Appendix I. The subordination agreements signed by both the other so-called "Refunding Mortgage creditors" and by WP Corp. are in substantially the same form.

The intent and effect of the agreements was and is to require all unmortgaged assets, including cash and current assets, to be applied to the 1934 interest on the First Mortgage Bonds prior to the application thereof to the creditors having claims junior to those of the holders of First Mortgage Bonds. The amount of the extended First Mortgage interest for 1934 exceeds the amount of cash, current assets and other unmortgaged assets, if any, on hand at the

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[1]R. 1092, 2529-39; I. C. C. Ex. 122 (see R. 2536-8), not printed.

[2]I. C. C. Ex. 118 (see R. 2533), not printed.

[3]I. C. C. Ex. 121 (see R. 2537-38), not printed.

[4]I. C. C. Exs. 117, 119, 120 (see R. 2532-35), not printed.

date of the filing of the Debtor's petition instituting these proceedings.

Can the Refunding Mortgage Trustee by any possibility have rights which the pledgees of *all* the Refunding Mortgage Bonds have expressly waived?

2. "Non-carrier Property"

The Refunding Mortgage Trustee also contends that the First Mortgage is not a lien on certain so-called "non-carrier property" to which, if it were unmortgaged assets, the alleged deficiency judgment under the Refunding Mortgage would extend.

This claim of the Refunding Mortgage Trustee refers principally to property at San Francisco, California, acquired by the Debtor at various dates at a cost of $1,586,395.54, similar property at Oakland, California, acquired at various dates at a cost of $355,813.16, and similar property at Sacramento, California, acquired at various dates at a cost of $40,896.91.

Most of the San Francisco property was acquired prior to July 14, 1916, the greater portion of it being the Islais Creek property.[1] The First Mortgage, therefore, is a prior lien thereon as property belonging to the predecessor of the Debtor and specifically covered in Granting Clause First of said First Mortgage. Moreover, the record shows that proceeds of First Mortgage Bonds were expended on account of acquisition of at least a part of the Islais Creek property, or for work thereon. Part of the property was acquired in 1921 and another part in 1925, and expenditures for the acquisition thereof were reimbursed to the Debtor in the amount of $176,734.68.[2]

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[1] R. 2527-28.

[2] I. C. C. Ex. 124 (see R. 2563), not printed.

The Oakland property consists of land acquired by the Debtor from its predecessor with the exception of a certain tract carried on the Debtor's books at $1,306.60, which was a part of a larger tract purchased for right-of-way purposes and financed by the use of deposited cash under the First Mortgage. The Sacramento property consists of land acquired by the Debtor from its predecessor and was a part of a larger tract purchased for station facilities.[1]

As pointed out in the discussion of the Granting Clauses of the First Mortgage (Point I, *supra*), the First Mortgage purports to be, and is, a first lien on all property which belonged to the predecessor of the Debtor of whatever kind or description. Not only is no distinction made in the First Mortgage as to the use to which such property may have been put, but Granting Clause Second expressly subjected to the lien of the First Mortgage, as a supplement to the particular description of railroad property contained in Granting Clause First, "all other * * * lands * * * now owned by or belonging to the Company, notwithstanding the same or any thereof may not be particularly set forth in these granting clauses."

Nowhere, either in the First Mortgage or in the Refunding Mortgage, can the term "non-carrier property" be found. That term had its origin in valuation proceedings made by the Interstate Commerce Commission pursuant to Section 19a of the Interstate Commerce Act long after the First Mortgage was created. The purpose of distinguishing between carrier and non-carrier property in proceedings involving valuation for rate-making purposes is sound. That, however, does not support the validity of such a dis-

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[1]Exhibit H to Stipulation as to Facts Not in Dispute (R. 1017, 1091, 1299), not printed.

tinction for the purpose of determining the lien of a mortgage.

All of the so-called "non-carrier property" of the Debtor was, in fact, formerly classified as "carrier" or "operative" property. For example, this same San Francisco property—the Islais Creek property—was formerly classified as "operative" property, but was transferred to "non-operative property."[1] Clearly a change in accounting classification of the property subject to the lien of the First Mortgage did not destroy the lien of that Mortgage.

The foregoing conclusions are not at all affected by the fact that the 1915 Reorganization Plan of the Debtor's predecessor described the First Mortgage to be created pursuant to that Plan as a first lien on "railroad properties."

Of the approximately $50,000,000 First Mortgage Bonds now outstanding, only $20,000,000 were issued in the 1916 reorganization.[2] To determine the rights of the present First Mortgage Bondholders this Court must look to the First Mortgage as it was actually executed, not to some antecedent and superficial description of it. Indeed, the 1915 Plan did not state that the proposed First Mortgage should not be a lien on other properties which the Debtor might acquire.

3. The Alleged Right to a Deficiency Judgment Under the Refunding Mortgage

None of the Refunding Mortgage Bonds has ever been issued by the Debtor except by way of pledge for the RFC, RCC and ACJ Notes. They therefore do not represent a *debt* of the Debtor.

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[1] See footnote *supra*, p. 34.

[2] R. 120-21. The 1915 Reorganization Plan was consummated in 1916.

It is elemental that the pledge of $2,000 of a debtor's mortgage bonds to secure a $1,000 note of the debtor does not increase the debt beyond $1,000.[1] The only significance of the pledged bonds is that they vest in their pledgees, as security for the primary obligations for which they have been pledged (here the RFC, RCC and ACJ Notes), the right to realize upon the mortgaged property as security for the primary obligations, proportionately to the respective amounts of such pledged bonds.

RFC, RCC and ACJ were, of course, vested by the primary obligations (their respective Notes) with powers of attorney from the Debtor to sell the pledged Refunding Mortgage Bonds at any time prior to the commencement of any legal proceedings against the Debtor designed to crystallize the rights of its creditors *inter se*, such as the appointment of an equity receiver or a bankruptcy trustee. After such appointment, however, a pledgee may not dilute the claims of other creditors of the Debtor by increasing its debt through the sale of such pledged bonds.[2] No such sale has ever been sought by any of the pledgees in the *Western Pacific* case.

Because bonds so pledged are not themselves a debt, but only an indicia of participation in mortgaged security, it is well established that no proof of claim can be made upon pledged bonds; and that they are not entitled as such

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[1] *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131 (1899); *Mississippi Valley Trust Co.* v. *Railway Steel Spring Co.*, 258 Fed. 346 (C. C. A. 8th, 1919); *Worth* v. *Marshall Field & Co.*, 240 Fed. 395 (C. C. A. 4th, 1917); *Butterfield* v. *Woodman*, 223 Fed. 956 (C. C. A. 1st, 1915); *Hitner* v. *Diamond States Steel Co.*, 176 Fed. 384 (C. C. Del., 1910).

[2] *Mississippi Valley Trust Co.* v. *Railway Steel Spring Co.* 258 Fed. 346 (C. C. A. 8th, 1919).

to a deficiency judgment.[1] The deficiency judgments in the present case (which admittedly exist) are for those parts of the RCC and ACJ Notes which have not been fully provided for by new securities in the reorganization. Those unsecured claims the Commission, as pointed out in the Committee's main brief, found "have no value."[2]

The Refunding Mortgage Trustee is, of course, wholly without standing to assert any rights in respect of those deficiency judgments.

V

ANOTHER "PRACTICAL INTERPRETATION"

While the following facts are concededly not conclusive, they have some persuasive effect as "practical interpretations," to borrow a phrase from the Refunding Mortgage Trustee:

All three plans originally proposed before the Commission by the Debtor, the Committee and ACJ were predicated on the full priority of the First Mortgage over the Refunding Mortgage, except as to the collateral specifically pledged under the latter.

The ACJ Second Plan, the Debtor's First, Second, Third and Fourth Plans and the RCC Plan were all predicated on that priority.

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[1] *Union National Bank* v. *People's Savings & Trust Co.*, 28 F. (2d) 326 (C. C. A. 3rd, 1928); *New York Trust Co.* v. *Palmer*, 101 F. (2d) 1 (C. C. A. 2nd, 1939); see *Jones* v. *Third Nat. Bank of Sedalia*, 13 F. (2d) 86, at 87 (C. C. A. 8th, 1926). See Hatch, *A Form of Depression Finance—Corporations Pledging Their Own Bonds* (1934) 47 Harv. L. Rev. 1093, 1103 *et seq.*

[2] See Committee's main brief, p. 18, and R. 269-70.

No question as to that priority was raised during the period of the negotiation of the Debtor's First Plan or of any of the other original plans.

No specific provision for the relative participation of the First Mortgage Bondholders and the collateral noteholders was made in any proposed plan which did not recognize such priority, until the filing before the District Court of the ACJ objections on December 8, 1939, containing the suggestion by ACJ of a wholly new plan never theretofore discussed.[1]

VI

CONCLUSION

The decision of the District Court approving the tentative determination by the Commission of the various lien questions should be affirmed.

Dated October 2, 1942.

Respectfully submitted,

ROBERT T. SWAINE,
Attorney for Frederick H. Ecker, John W. Stedman and Reeve Schley, constituting the Institutional Bondholders Committee, Respondent.

HERBERT W. CLARK,
BENJAMIN R. SHUTE,
Of Counsel.

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[1] R. 892, 910.

APPENDIX I

I. C. C. EXHIBIT 117[1]

A. C. JAMES CO.
40 Wall Street
New York

July 2, 1934.

The Western Pacific Railroad Company,
37 Wall Street,
New York.

Dear Sirs:

We refer to the letter written to you by the Reconstruction Finance Corporation dated June 23, 1934, and signed by the Chairman of such Corporation.

Subject to your obtaining from the holders of at least 75% of your outstanding First Mortgage Bonds, assents to the agreement of extension, dated as of March 1, 1934, as modified by the additional conditions contained in the printed letter of The Western Pacific Railroad Company dated May 29, 1934 (omitting the condition that the Reconstruction Finance Corporation, The Railroad Credit Corporation, A. C. James Co. and The Western Pacific Railroad Corporation shall in writing unconditionally consent and agree as provided in paragraph 2 contained in said printed letter and substituting therefor that the Reconstruction Finance Corporation, The Railroad Credit Corporation, A. C. James Co. and The Western Pacific Railroad Corporation shall agree as herein set forth) and subject to your obtaining from The Railroad Credit Corporation the Reconstruction Finance Corporation, and The Western Pacific Railroad Corporation an agreement with respect to their

[1]Introduced at R. 2532.

respective loans to your Company similar to the agreement herein contained (with like exception with respect to collateral held by them respectively and in the case of The Railroad Credit Corporation its right to retain sums payable under the Marshalling and Distributing Plan 1931), this corporation agrees, in the circumstances, that it will not, prior to January 1, 1937, or should prior to such date receivers be appointed for the Railroad Company or the filing of a petition by or against it be allowed by the Court under Section 77 of the Federal Bankruptcy Act, as amended, then prior to the appointment of such receivers or the allowance of the filing of such petition, whichever may be earlier, take any action with respect to collecting the interest falling due during the calendar year 1934 on loans of this Corporation to the Railroad Company, and further agrees that, until such time as the 1934 extended interest on the First Mortgage Bonds shall be paid in full, the 1934 extended interest on such assenting First Mortgage Bonds shall be entitled to priority of payment over interest and principal of loans of this Corporation to the Railroad Company (except with respect to assets or the income therefrom on which any mortgage securing bonds comprised in the collateral pledged as security for loans of this Corporation is a lien prior to the lien of said First Mortgage and except the collateral for such loans or the proceeds thereof or any payments which may be received by this Corporation therefrom or be realized by it out of the same) in any proceedings commenced prior to July 1, 1937, whether taken by this Corporation to enforce payment of interest or principal of such loans or otherwise.

Yours very truly,

A. C. JAMES CO.

By E. HAYWARD FERRY
Vice President.